Agenda Date: 5/5/06
Agenda Item: 2A-1

STATE OF NEW JERSEY

Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
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ENERGY

I/M/O PUBLIC SERVICE ELECTRIC AND GAS COMPANY - PRIVATE LETTER RULING REQUEST SEEKING A FINDING THAT THE CONTINUED FLOW-THROUGH TO RATEPAYERS OF UNAMORTIZED INVESTMENT TAX CREDITS ASSOCIATED WITH CERTAIN DIVESTED GENERATING ASSETS WOULD NOT VIOLATE THE IRS' NORMALIZATION RULES	)	ORDER ON MOTION FOR RECONSIDERATION DOCKET NO. EO06040313

(SERVICE LIST ATTACHED)

BY THE BOARD:

Before the Board of Public Utilities ("Board" or "BPU") is a motion by Public Service Electric & Gas Company ("PSE&G" or "Company") for reconsideration of the April 26, 2006 Order in the within matter by which the Board directed PSE&G to withdraw its request to the Internal Revenue Service ("IRS") for a Private Letter Ruling ("PLR") regarding the flow-through to ratepayers of unamortized Investment Tax Credits ("ITC") and indicated that PSE&G may state in its withdrawal that if the IRS agrees not to issue a PLR until after there has been a final resolution of an IRS rulemaking that addresses the tax implications of flowing through the ITC to ratepayers, including any appeals from the rulemaking, then PSE&G's request for a PLR shall be deemed not to be withdrawn. The Division of the Ratepayer Advocate ("RPA") has submitted opposition to PSE&G's motion for reconsideration. At the Board's May 5, 2006 special agenda meeting, PSE&G and the RPA were afforded the opportunity to present oral argument, which the Board has carefully considered along with the written submissions in support of and opposition to the motion for reconsideration.[1]

[1] At its May 5, 2006 special agenda meeting, the Board also heard oral argument by Jersey Central Power & Light Company ("JCP&L") with regard to its motion for reconsideration of the Board's Order in Docket No. EO06040314 directing it to withdraw its PLR regarding the flow-through of ITC and excess deferred income taxes associated with

BACKGROUND

As part of its August 24, 1999 Final Decision and Order in I/M/O Public Service Electric & Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, Docket Nos. EO97070461 *et al.* ("1999 Order" or "Final Order"), the Board adopted, with specific modifications and clarifications, elements of a non-unanimous Stipulation between PSE&G and a number of parties in that proceeding ("Stipulation"). As part of the 1999 Order, the Board approved the transfer of PSE&G's generating assets to an unregulated affiliate. At the time, PSE&G had a significant accumulated deferred investment tax credit ("ADITC") balance attributable to its generation assets. The Stipulation did not resolve the disposition of the ADITC balance upon the transfer of the generation assets. The BPU's 1999 Order specifically held this issue open and directed PSE&G to seek a PLR from the IRS to determine whether or not the value of the ITC could legitimately be credited to customers without violating the tax normalization policies of that agency. 1999 Order, at 125. By Order dated July 22, 2002 in I/M/O Petition of Public Service Electric and Gas Company for Approval of Changes in its Tariff for Electric Service, Depreciation Rates, and for Other Relief, Docket Nos. ER02050303 *et al.*, at 5-6, the Board reiterated its directive to PSE&G to seek the letter ruling from the IRS.

In accordance with that directive, by letter dated October 15, 2002, PSE&G requested the IRS to rule that it "will not violate the requirements of the investment tax credit normalization rules set forth in former Code §46(f) if it credits to customers the ADITC associated with the generating assets which have been sold to PSEG Power LLC as a part of Taxpayer's restructuring." (October 15, 2002 letter at 4). No final PLR has been issued by the IRS on this request to date.

By notice published at 68 Fed. Reg. 10190 (March 4, 2003), encaptioned "Application of Normalization Accounting Rules to Balances of Excess Deferred Income Taxes and Accumulated Deferred Investment Tax Credits of Public Utilities Whose Generation Assets Cease To Be Public Utility Property," the IRS proposed regulations providing for the flow-through of Excess Deferred Income Taxes ("EDFIT") and ADITC, concluding that neither former section 46(f) nor section 203(e) of the Tax Reform Act suggest that EDFIT and ADITC reserves should not ultimately be flowed through to ratepayers and that such flow-through therefore could occur without violating normalization rules. The regulations were proposed to apply to property deregulated after March 4, 2003, and utilities could elect to apply the proposed rules to property that became deregulated generation property prior thereto. The Board filed comments in support of the proposed regulations.

On December 21, 2005, the Board initiated a generic proceeding (BPU Docket Nos. EX02060363, EX02060364, EX02060365, EX02060366) in order to formulate an appropriate regulatory treatment for ITC related to generation assets. Comments were

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certain divested generation assets, and opposition to JCP&L's motion by the RPA. The Board's ruling on the JCP&L motion will be set forth by separate Order in that docket.

solicited and received from the State's electric distribution companies and the RPA.

Also on December 21, 2005, the IRS withdrew its March 4, 2003 proposed rulemaking and proposed new regulations by notice published at 70 Fed. Reg. 75762 (December 21, 2005), captioned "Application of Normalization Accounting Rules to Balances of Excess Deferred Income Taxes and Accumulated Deferred Investment Tax Credits of Public Utilities Whose Assets Cease to Be Public Utility Property," with corrections published at 70 Fed. Reg. 76433 (December 27, 2005). The IRS again concluded that such flow-through would not violate normalization requirements provided certain criteria are met and proposed to permit such flow-through, but limited, however, to plant that ceased to be public utility property after December 21, 2005, with certain exceptions for plant that ceased to be public utility property on or after March 5, 2003. The Board has commented on the proposed regulations and urged the IRS to make certain modifications thereto, including, among other things, elimination of the arbitrary time constraints for allowing the flow-through to ratepayers of unamortized investment tax credits and excess deferred income taxes associated with divested utility plant.

In March 2006, the IRS informed PSE&G that it was tentatively adverse to the 2002 PLR requested by PSE&G. On April 6, 2006, at the Company's request, and pursuant to IRS procedures, a Conference of Right was held by telephone with the IRS and PSE&G, along with representatives of the Board. The IRS indicated that comments could be submitted within 21 days through PSE&G.

APRIL 26, 2006 ORDER

By telephone conference call on April 20, 2006, confirmed by letter dated April 21, 2006, the Board's Staff provided notice to the affected utilities and the RPA that this matter would be considered by the Board at its April 26, 2006 agenda meeting, and that the Board's Staff anticipated that it may recommend to the Board that, in light of the subsequent events described above, it reconsider prior directives to PSE&G, as well as directives to Jersey Central Power and Light Company ("JCP&L") and Atlantic City Electric Company ("ACE"), to seek PLRs from the IRS that the flow-through to ratepayers of unamortized investment tax credits and excess deferred income taxes associated with divested generation plant would not violate IRS normalization rules. The notice further indicated that Staff may recommend that the Board revoke its aforementioned prior directives to seek PLRs and direct the utilities to withdraw their requests for PLRs from the IRS immediately, with the flow-through issue continuing to be considered by the IRS in the context of its rulemaking, subject to judicial review. An opportunity for each utility and RPA to submit comments on whether these actions should be taken by the Board was provided. PSE&G, JCP&L, ACE and the RPA provided comments.

By letter dated April 24, 2006, from Wilentz, Goldman & Spitzer P.A., by John A. Hoffman, Esq. ("PSE&G letter"), PSE&G objected to the potential Board action on procedural and substantive grounds, and argued that "a withdrawal of the ruling request would accomplish nothing." PSE&G letter, at 1. It further asserted that once the ruling

request was filed, "it became a matter between the Company and the IRS, and it would be inappropriate for the Board to intrude into that bilateral process." PSE&G letter, at 1-2.

As to its procedural objections, PSE&G argued that the Staff recommendation should have been made by motion in accordance with rules governing motions in contested cases, including N.J.A.C. 1:1-12.2. It further contended that pursuant to N.J.A.C. 14:1-8.4, the Board may only reopen a proceeding if it has "reason to believe that conditions of fact or law have so changed as to require, or that the public interest requires, the reopening" and that the fact that the IRS may issue a ruling with which the Staff does not agree does not constitute a changed condition of fact or law, as the possibility that the IRS might rule that the credits could not be flowed-through to ratepayers had been contemplated when the Board issued the directive to file for a PLR. PSE&G also argued that there is no justification to invoke N.J.A.C. 14:1-8.6 to reconsider the prior Order.

PSE&G also maintained that a withdrawal of the PLR request will not alter the underlying tax law or the agency's interpretation of that law, and if the Staff believes that withdrawal of the ruling request will produce a more benign forum for consideration of the issue, it is wrong. While agreeing with the IRS that there is no appeal from an adverse PLR, it also asserted that there is no avenue of appeal from the issuance of adverse final regulations and that the "due process" steps in the rulemaking are not materially more robust, if at all, than in connection with the PLR request. It contended that "Staff's implication that somehow a normalization rulemaking would be judicially reviewable in a sanitized or declaratory fashion is incorrect." PSE&G letter, at 4. It also asserted that withdrawal of the ruling would not diminish the Company's chances of being assessed on audit should there be a normalization violation, and it noted that under applicable IRS procedures, if a PLR request is withdrawn, the IRS National Office still notifies the taxpayer's IRS auditors of its views as to its conclusions.

PSE&G further claimed that if the pending rulemaking when finalized permits the flow-through of its generation-related ADITC balance to customers without violating normalization rules, the finalized regulations would supersede any previously issued PLR. Thus, it asserted that if the normalization rules are retroactively altered, the PLR would not, as a matter of tax law, preclude application of the altered law, and therefore, issuance of a PLR would not preclude application of any new regulations which would otherwise apply. PSE&G also noted that it is not the only taxpayer with this issue, New Jersey is not the only state with taxpayers with this issue, there likely will be other PLRs on this issue even if PSE&G's request is withdrawn, and while such rulings would not be legally binding on the Company, "the reasoning is likely to be transparently applicable." PSE&G letter, at 5.

PSE&G also pointed to the IRS procedures for normalization rulings, which provide for additional inputs from the regulatory authority and consumer advocate, but which, once the additional inputs are received, it maintained reverts to a bilateral process between the IRS and taxpayer, and provides the taxpayer with tax, not regulatory, advice.

PSE&G stated that it "deems it critical that it be apprised of the tax consequences of the regulatory treatment described in the ruling request." PSE&G letter, at 5. PSE&G, therefore, concluded that the IRS PLR process should be continued to its conclusion so as to receive the IRS position sought by the Board in the 1999 Order.

By letter dated April 24, 2006 from the RPA by Diane Schulze, Assistant Deputy Ratepayer Advocate ("RPA letter"), the RPA requested that the Board order PSE&G, as well as JCP&L and ACE, to immediately withdraw their PLR requests addressing the ITC issue due to the proposed IRS regulation on the issue. The RPA maintained that with the delay in the IRS responding to the PLR requests, circumstances have changed to make the rulings no longer necessary. The RPA asserted that the "letter rulings are no longer necessary and may even be detrimental to obtaining clarification on the issue." RPA letter, at 7. The RPA asserted that the Board's directive to file for a PLR was made with the expectation of a timely IRS response, and when a response from the IRS was not forthcoming, and the Board was forced to make stranded cost determinations without IRS guidance. The RPA further argued that "issuance by the IRS of the proposed regulations effectively superseded any previous request for a private letter ruling" and in the interest of ensuring uniform treatment, the utilities should have withdrawn their requests with issuance of the March 2003 proposed regulations. RPA letter, at 8. The RPA contended that an adverse ruling at this late date will "severely limit" the Board's options in protecting ratepayers' interests, while if the PLR request is withdrawn, the Board would have the flexibility to await the IRS regulation and once the IRS' final position is public, to act accordingly. It also asserted that piecemeal determinations should be discouraged and the full IRS rulemaking should proceed before making a final determination on the ADITC reserves. Maintaining that the proper way to resolve the issues is through rulemaking, which includes both the opportunity for fair comment and standing to appeal, the RPA requested the Board to direct the utilities to immediately withdraw their requests for PLRs.

After carefully considering the submissions of PSE&G and the RPA, the Board issued its ruling by Order dated April 26, 2006. As to PSE&G's procedural contentions, the Board found that its Staff, which is acting in an advisory capacity to the Board with regard to the PLR request and the IRS rulemaking, was not required to first file a formal motion consistent with the time constraints of a motion in a contested case. The PLR request is not a contested case before the Board. Nonetheless, Staff sent the letter to the affected parties in order to solicit their respective positions on this issue, so that they could be conveyed to and considered by the Board when it considers this issue. Moreover, the Board explained that because comments to the IRS were due by April 27, there was a need to consider this matter expeditiously. The Board noted that PSE&G had had an opportunity to provide its comments to the Board, and had, in fact, submitted detailed comments, such that any informality or irregularity had not impaired PSE&G's rights or interests.

The Board then observed that the IRS has clearly recognized that the flow-through issues are appropriate for rulemaking by publishing two notices of proposed regulations, in 2003 and 2005. While the IRS has indicated that,

before its 2003 proposed rulemaking, it had issued PLRs holding that flow-through of the EDFIT and ADITC reserves associated with an asset is not permitted after the asset's deregulation, based on the principle that flow-through is permitted only over the asset's regulatory life and when that life is terminated by deregulation no further flow-through is permitted, after further consideration, the IRS and the Department of Treasury have concluded that the relevant statutory provisions do not prohibit a utility from flowing through ADITC reserves after deregulation and EDFIT reserves with respect to deregulated utility property. 2005 Rulemaking, at 75763. The Board also noted that as to the flow-through of ADITC reserves, the IRS further explained in its 2005 Rulemaking:

> If an asset qualifying for the investment tax credit is purchased by a utility, the allowance of the credit, without flow-through, lowers the utility's actual tax expense but does not result in higher tax expense for ratepayers than would have been the case if the asset had not been purchased. Thus, in the absence of flow-through, the investment tax credit is a subsidy from the Federal government for the purchase of the asset rather than a transfer from ratepayers to the utility. The underlying policy of former section 46(f) is to share this subsidy between ratepayers and utilities in proportion to their respective contributions to the purchase price. In general, former section 46(f) treats ratepayers as contributing to the purchase price when ratemaking depreciation expense with respect to the asset is included in the rates they pay, resulting in full flow-through over the asset's regulatory life. In the case of a deregulated asset, the contribution of ratepayers can be appropriately measured by the ratemaking depreciation expense they are charged with respect to the asset and any additional stranded cost that the utility is permitted to recover with respect to the asset after its deregulation.
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> [2005 Rulemaking, at 75763 (emphasis supplied)].

Accordingly, based on the IRS' interpretation of the relevant statutes and their underlying policy and intent, the proposed regulations would permit flow-through of the ADITC reserve with respect to public utility property to continue after its deregulation to the extent the reduction in cost of service does not exceed, as a percentage of the ADITC with respect to the property at the time of deregulation, the percentage of the total stranded cost that the taxpayer is permitted to recover with respect to the property. In addition, the credit may not be flowed through more rapidly than the rate at which the taxpayer is permitted to recover the stranded cost with respect to the property.

The Board further noted that although the 2003 proposed regulations would have permitted utilities to elect to apply the proposed rules to property that was deregulated on or before March 4, 2003, the 2005 Rulemaking proposed other provisions pertaining to the regulations' effective date:

> Comments suggested that deregulation agreements between utilities and their regulators entered into before the March 4, 2003 proposed effective date were based on the only guidance then available (*i.e.* ,the private letter rulings issued by the IRS) and that the availability of a retroactive election could effectively change the terms of those agreements. Although private letter rulings are directed only to the taxpayers who requested them and may not be used or cited as precedent, the IRS and Treasury have concluded that the Secretary's authority under section 7805(b)(7) to provide for retroactive elections should not be exercised in a manner that impairs existing agreements between utilities and their regulators.
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> [2005 Rulemaking, at 75763 (emphasis supplied)].

The Board also noted that, as it had explained in its comments on the proposed regulations, this proposed rationale for eliminating retroactivity simply does not apply to the situation in New Jersey. Although New Jersey's electric industry completed its deregulation prior to March 2003, the Board specifically carved out the issue of proper treatment of ADITC in its restructuring orders, including PSE&G's 1999 final restructuring order. The Board observed that in PSE&G's request for a PLR, PSE&G so recognized in stating that neither the Stipulation nor the Board's Final Decision and Order provided for the disposition of ADITC upon the impending sale of the assets.

Thus, the Board explained that its 1999 Order did not depend at all on any PLRs that preceded it. On the contrary, the Board's 1999 Order left this issue open and directed PSE&G to seek a letter ruling from the IRS to determine whether or not the value of the ITC can legitimately be credited to customers without violating the tax normalization policies of that Agency to the detriment of the Company and the customers. The Board stated that accordingly, flow-through could be allowed without making any change in the terms of the Board's 1999 Order and without making any change in the basis for that order contemplated by the parties at the time it was issued, and without impairing any existing agreements between utilities and their regulators. The Board noted that the reasoning underlying the 2005 Rulemaking's effective date therefore is inapplicable to PSE&G's request and should be modified, as the Board submitted in its rulemaking comments to the IRS.

In its April 26, 2006 Order the Board further discussed that notwithstanding its own proposal of rules in March 2003 to interpret the relevant statutory provisions, and its own proposal of rules again in December 2005, and its having afforded opportunities for interested parties to provide comments on the proposals for the IRS' consideration, the IRS apparently now seeks to issue interpretations through a series of PLRs addressing PSE&G, two other New Jersey utilities, Jersey Central Power & Light Company, and Atlantic City Electric Company, and possibly a number of other utilities as well. While the IRS has indicated that the Board and the RPA may submit comments on this issue by April 27, 2006, through the taxpayer utility, the IRS has asserted further that no such third party would have standing to contest a PLR through judicial review. The Board

expressed its strong view that the IRS should not take action of such broad scope and applicability, with such a large financial impact on millions of ratepayers, through a piecemeal process that eliminates any real scrutiny on behalf of the many people affected by the action. The IRS should, as it is in the process of doing, resolve the outstanding questions by considering the comments of the Board and other interested parties and finalizing its proposed rulemaking, subject to such judicial review as may be appropriate. The Board explained that were the IRS to issue a PLR without first completing its pending rulemaking, including that part of the rulemaking pertaining to the effective date for the IRS' statutory interpretations, it would vitiate the opportunity to be heard that was to be provided to the Board and other interested parties in the rulemaking, and would prematurely judge issues prior to their full and due consideration by the IRS pursuant to its own notice of rulemaking. Moreover, proceeding in such manner could result in disparate treatment depending on whether a public utility sought a PLR or is governed by the rulemaking. Such disparity would be particularly unfair in the context of a regulatory agency such as the Board, which attempted to obtain guidance from the IRS, even prior to the rulemaking. Additionally, the Board noted that as to PSE&G's contention that the finalized regulation would supersede any previously issued PLR, that is not certain at this juncture, and, in fact, the IRS' current proposal provides that as to public utility property deregulated on or before December 21, 2005, the IRS will follow holdings set forth in previously issued PLRs.

For the foregoing reasons, in recognition of the changed circumstances since its 1999 Order, and after careful consideration and balancing of the interests and concerns of PSE&G, which, in its request for a PLR, supported and argued for the flow-through of ADITC to ratepayers, and the interests of its ratepayers, who, prior to divestiture, funded PSE&G's assets through depreciation charges and who, post-divestiture, continue to fund nearly $3 billion in stranded costs related to these generating assets, the Board, in its April 26, 2006 Order set forth its belief that the flow-through issues should be considered in the pending rulemaking and the IRS, therefore, should not issue a PLR to PSE&G to address these same issues prior to the final resolution of the pending rulemaking. The Board emphasized that proceeding in this manner is consistent with Internal Revenue Procedures which provide that letter rulings are given when appropriate in the interest of sound tax administration, and that the IRS "will not issue a letter ruling if the request presents an issue that cannot be readily resolved before a regulation or any other published guidance is issued." Rev. Proc. 2006-6.09. While the Board concurred with PSE&G as to the need for the IRS' guidance as to the tax consequences of a flow-through of ADITC to ratepayers, given the IRS' own rulemakings proposing different provisions as to effective dates of the IRS' statutory interpretations, the Board found that the request at issue cannot be readily resolved before the rulemaking concludes. The Board also noted that IRS procedures also provide that a taxpayer may withdraw a request for a letter ruling at any time before the letter ruling is signed by the IRS, Rev. Proc. 2006-7.07, and the Board found that in the within context, unless the IRS will grant a request to hold the PLR request in abeyance pending the rulemaking, PSE&G should withdraw its PLR request.

Accordingly, pursuant to N.J.S.A. 48:2-40, and in light of the subsequent events

described above that have occurred since the issuance of the 1999 Order, the Board modified its prior directive to PSE&G to seek a PLR, and directed PSE&G to deliver to the IRS, by 5:00 p.m. on April 27, 2006, a withdrawal of its request for a PLR. However, the Order further provided that PSE&G may state in its withdrawal that if the IRS agrees not to issue a PLR until after there has been a final resolution of an IRS rulemaking that addresses the tax implications of flowing through the ITC to ratepayers, including any appeals from the rulemaking, then PSE&G's request for a PLR would be deemed not to be withdrawn.[2] The Board emphasized that its determination whether the ITC is to be flowed through to ratepayers continues to remain open pending the resolution of the issue through IRS rulemaking, and that the Board is not directing flow-through of the ITC at this time. The Board also directed PSE&G to deliver to the IRS, by 5:00 p.m. on April 27, 2006, comments to be received from the BPU which would urge that the PLR request be held in abeyance, as well as comments by the RPA with respect to the proposed PLR.

MOTION FOR RECONSIDERATION

By letter dated April 27, 2006 from Wilentz, Goldman & Spitzer P.A., by John A. Hoffman, Esq., PSE&G informed the Board that PSE&G intended to file a motion for reconsideration of the April 26, 2006 Order on or before 5 p.m. on May 1, 2006, and that PSE&G had requested and the IRS had granted an extension of the comment period until May 8, 2006. PSE&G, therefore, requested that the Board stay its Order until May 8, 2006, in order to consider the motion. By letter dated April 27, 2006, Board Secretary Izzo informed PSE&G that, based on the representation that the IRS had extended the deadline for comments on the PLR request until May 8, 2006, the Board extended the two deadlines in its April 26, 2006 Order until 5:00 p.m. on May 8, 2006.

By letter dated May 1, 2006, from Wilentz, Goldman & Spitzer P.A., by John A. Hoffman, Esq. ("PSE&G motion"), PSE&G requests that the Board reconsider the directive set forth in its April 26, 2006 Order that PSE&G withdraw its PLR request. PSE&G contends that reconsideration is appropriate because "there has been some confusion about the language of the Board's August 1999 Final Order in the PSE&G electric restructuring case..., specifically as it reflects the expectations of the Company and the Board with regard to the treatment of investment tax credits...associated with the Company's generation assets." PSE&G motion, at 1-2. Noting that it has over many decades valued its relationship with the Board and has in the past complied with the Board's legally adopted mandates, PSE&G expresses "serious reservations" about the wisdom and efficacy of withdrawing its PLR request and the legality of the Order, and it asks the Board to "seriously consider the position of the Company as a taxpayer with a legitimate question for the IRS, a question the Company has invested several years trying to get answered." PSE&G motion, at 2. It also asks that the Board consider that, in contrast to orders for other utilities for which the final resolution of plant valuation and stranded cost determinations were made contingent upon the outcome of

[2] At oral argument on May 4, 2006, counsel to PSE&G advised that the Company had not yet submitted a written request to the IRS to hold the PLR in abeyance, or taken any action to this end other than an informal telephone conversation with IRS staff.

the ITC issue, for PSE&G, the stranded cost determinations were made in the 1999 Order. PSE&G, "[i]n deference to the Board's concerns" offers that it would "acknowledge and agree that, in the event that the IRS' final regulations retroactively permit flowthrough to customers, the Board could then consider any action it may take, including seeking to flow through such funds, giving due consideration to the elements of the Settlement and the Board's Final Order, subject to PSE&G's continuing right to argue its position based on the intent of the Final Order." PSE&G motion, at 2.

With regard to PSE&G's restructuring, the Company asserts that it had submitted a comprehensive stipulation negotiated by it and certain other parties resolving the issues in its electric restructuring proceeding and that, by Summary Order dated April 21, 1999, the Board adopted the Stipulation with modifications, and rejected a Stipulation of the RPA and certain other parties. PSE&G maintains that the Stipulation as modified in the Summary Order was "a comprehensive resolution of the complex restructuring proceeding, containing numerous benefits and imposing numerous costs on PSE&G, its customers and all related stakeholders." PSE&G motion, at 2. Among other things, PSE&G notes that the magnitude and phase-in schedule of the Board-ordered rate reductions were more favorable to customers than those in the Stipulation, which were more favorable than the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et seq. ("EDECA") required. PSE&G further asserts that "[t]he Stipulation also resolved the magnitude of the Company's stranded cost recovery, providing for the recovery of stranded costs in an amount that was hundreds of millions of dollars below PSE&G's calculation in the litigated stranded cost proceeding," which was reduced more in the Summary Order. PSE&G motion, at 3.

PSE&G contends that while neither the Stipulation nor Summary Order expressly addressed the issue of investment tax credits associated with its generating assets which were to be transferred to PSE&G's unregulated generation affiliate, PSE&G indicated in discussions with Board Staff prior to and after the Summary Order's issuance and in various filings and discovery responses, that under existing law and IRS practice, it intended to retain the ITC, as transferring them to ratepayers would have resulted in a violation of IRS' normalization rules, causing a recapture or repayment of all ITC to the Treasury. Ibid. It also contends that its retention of the ITC was considered in the settlement negotiations and incorporated in various elements of the Stipulation. Ibid. PSE&G argues that in the 1999 Final Order, the Board made further modifications and with respect to ITC, noted that the Stipulation did not provide for the ITC to be flowed through to ratepayers and directed PSE&G to seek an IRS letter ruling as whether ITC could be legitimately credited to customers without violating IRS normalization policies. PSE&G quotes from the Order as stating that if the IRS issues a letter ruling that ITC cannot be passed through to customers, this issue will be moot, and in the event a ruling is issued "favorable to the proposition that the ITC can be passed onto customers, then the Board in year four of the Transition Period will consider any action which it may deem appropriate, giving consideration to the issues resolved in the Stipulation of March 17, 1999, the Board's modifications to that Stipulation, and other relevant considerations which the parties might bring to the Board's attention in that review of the issue during year four of the Transition Period."

PSE&G motion, at 3, quoting (with emphasis added) 1999 Order, at 112-13. PSE&G contends that the 1999 Order's language indicates that with an IRS ruling that ITC cannot be passed onto ratepayers, the issue would be concluded and ITC not passed on to ratepayers, but with an IRS ruling that ITC can be passed onto customers, the pass-through would not automatically occur but rather the Board would review the issues and take into consideration the factors specified in the 1999 Order. This, it asserts, is in contrast to language in other utilities' restructuring Orders, in which the final determination of net proceeds and stranded costs would await the IRS' PLR.

PSE&G also maintains that the stranded costs associated with plants it transferred to its affiliate were established in the Final Order and were not to be modified pending the PLR. It also notes that although, pursuant to the Board's 1999 and July 22, 2002 Orders, it filed the PLR request so as to argue in favor of ITC flowthrough, it believed that the ITC could not be credited to customers without violating the normalization rules and that the IRS would so rule, and it accounted for the ITC as a reduction to the write-off of the transferred generating plants. PSE&G motion, at 4.

PSE&G maintains that in the more than six years since the Final Order, it has abided by its terms, including making the request for a PLR. PSE&G argues that while the Board appears concerned that the status quo would be disturbed as a result of the issuance of the PLR, the status quo is that the Company was directed to seek a PLR, which it did, and that the PLR would only resolve the issue if the IRS does not change the proposed regulations, which permit flowthrough to customers with respect to transfers after December 21, 2005, with certain exceptions for plants that cease to be public utility property after March 5, 2003. PSE&G indicates that because the Board seems to be concerned that if PSE&G receives an adverse PLR, the Board would be precluded from revisiting the ITC issue if the IRS were to ultimately issue regulations that otherwise would have allowed flowthrough by the Company, PSE&G, therefore, would be willing to agree that "if final regulations are issued to permit flowthrough (either in the initial regulations or in regulations issued following an appeal by the Board), the Company will not object to the Board considering the issue, subject to the Company reserving its rights to argue for the enforcement of its expectations under the Stipulation and Final Order...that is, to argue that in light of the stranded cost reduction and other customer benefits provided under the Stipulation and Final Order, the ITC should in fact remain with the Company." PSE&G motion, at 6. PSE&G contends that in this way, issuance of the PLR would not compromise the Board's ability to consider ITC flowthrough if permitted by IRS regulations. Ibid.

By letter dated May 4, 2006 from the RPA by Diane Schulze, Assistant Deputy Ratepayer Advocate ("RPA response"), the RPA submits that PSE&G's motion for reconsideration should be denied because it presents no legal or factual basis for reconsideration. The RPA cites to N.J.A.C. 14:1-8.6(a) as requiring a motion for reconsideration to state the "alleged errors of law and fact relied upon" and argues that PSE&G has not pointed to any errors of law or fact that should cause the Board to reconsider its decision. Noting that without pointing to any particular errors in the Board's ruling, the Company asserts that the Board must be "confused" about its Final

Order and asks that the Board "seriously consider" the Company's position as "a taxpayer with a legitimate question for the IRS," the RPA asserts that PSE&G then repeats argurnents previously presented in its April 24, 2006 letter. RPA response, at 2, quoting PSE&G motion, at 1-2.

The RPA submits that the Board has "seriously considered" the ITC issue and that in its motion for reconsideration, PSE&G has not addressed the Board's comments to the IRS on its 2005 rulemaking in which it explained the rulemaking's potential adverse impact on ratepayers. As to the Company's claim that neither the Stipulation nor Summary Order expressly addressed the ITC issue and that retention of the ITC was considered in settlement negotiations and incorporated into elements of the Stipulation, the RPA asserts that the Company is wrong in that the Summary Order directed PSE&G to provide the Board accounting entries and information to "include all tax effects, both current and deferred, and the disposition of the accumulated balance of investment tax credits and the related amortization, if any..." RPA response, at 3, quoting Summary Order, at 6. The RPA claims that, at the time of the Summary Order, the Board apparently was "aware of the ITC issue, the impact on stranded costs and the expected continued amortization of these credits." RPA response, at 3. Asserting that the Company's vague allusions to discussions with Board Staff and its claim that it incorporated into the Stipulation its retention of ITC is not a basis for reconsideration, the RPA further notes that there is no mention of the ITC reserve in the Stipulation itself.

The RPA also argues that it is unclear why, despite filing a request for a PLR in favor of ITC flowthrough, PSE&G believed that the request would not result in flowthrough, and that what is clear is that in its PLR request, PSE&G acknowledged that the Board had specifically carved out the issue of ITC treatment in its orders. The RPA further asserts that ITC was, contrary to PSE&G's claim of different treatment, excluded from the stranded cost determinations as it was for the other utilities. The RPA submits that the Final Order was based on the record evidence in the restructuring proceeding, not upon discussions or unspecified documents. Thus, the RPA submits that the motion for reconsideration has added nothing new and should be rejected.

As to PSE&G's proposal for a resolution, the RPA asserts that the proposal is meaningless. Citing language of the current proposed IRS regulation, the RPA argues that if the proposed regulation is adopted without modification, it appears that in cases in which a PLR is issued, the PLR will control, and regulations to the contrary will not apply. It argues that, on the other hand, absent issuance of a PLR, the IRS regulations would govern the flowthrough issue. The RPA, therefore, contends that "[w]ithout withdrawal of the request, even if the [Board's rulemaking] comments are effectual, the private letter ruling will supersede the regulation, the Board will be denied the due process and ratepayers will be denied the benefit of excess tax payments made to the utility." RPA response, at 6. Accordingly, the RPA submits that PSE&G's motion for reconsideration should be denied.

DISCUSSION AND FINDINGS

The Board has carefully considered the written and oral arguments that PSE&G presented in support of its motion for reconsideration, as well as the written and oral arguments presented by the RPA. The Board FINDS that PSE&G, in support of its motion for reconsideration, has offered no new material facts or law that would provide a basis for modifying the April 26, 2006 Order.

PSE&G questions the legality of the Board's April 26, 2006 Order, asking the Board to "seriously consider the position of the Company as a taxpayer with a legitimate question for the IRS." The Board recognizes that PSE&G is a taxpayer, and that the question it has posed to the IRS is a legitimate one. However, PSE&G differs from a typical taxpayer seeking a typical PLR, in two ways.

First, PSE&G is a public utility, which is subject to regulatory authorities inapplicable to non-utility taxpayers. The Board has been granted "general supervision and regulation of and jurisdiction and control over all public utilities . . . and their property, property rights, equipment, facilities, and franchises so far as may be necessary" for the purpose of carrying out its statutory responsibilities. N.J.S.A. 48:2-13. The Board's statutory responsibilities include ensuring just and reasonable rates. N.J.S.A. 48:2-21; In re N.J. Am. Water Co., 169 N.J. 181, 187 (2001). The resolution of PSE&G's legitimate question for the IRS is one that can affect the rates that its customers pay. If the question is resolved so that PSE&G can flow its deferred tax benefits through to ratepayers without putting the Company in violation of applicable tax law, then the resolution of the question may, subject to the further considerations as set forth in the 1999 Order and referenced by PSE&G in its motion, help to reduce rates. If the question is resolved in a way that prohibits flow-through, then the resolution will not help to reduce rates. The Board notes that the ratepayers funded PSE&G's assets through depreciation charges prior to divestiture, and post-divestiture the ratepayers continue to fund nearly $3 billion in stranded costs related to those generating assets. As a result, the Board and the ratepayers have an especially strong interest in the disposition of tax benefits related to those same generating assets.

Second, the legitimate question that PSE&G seeks to have the IRS answer is one of very strong interest to the Board and to the RPA as well. A PLR is a written statement that the IRS issues to a particular taxpayer, to interpret and apply tax laws to that particular taxpayer's specific set of facts. For that reason, in a typical PLR, third parties beyond the taxpayer and the IRS do not normally hold such strong interests in the outcome.

Accordingly, the Board has seriously considered the position of PSE&G as a taxpayer with a legitimate question for the IRS, and concluded that this public utility taxpayer should not seek an answer to its question, a question also for the Board and the RPA, in a way that would conflict with the Board's obligation to ensure just and reasonable rates.

PSE&G also questions the wisdom and efficacy of withdrawing its request for a PLR.

For several reasons, the Board continues to believe that having the request withdrawn (unless the IRS agrees to hold it in abeyance pending final resolution of an applicable rulemaking), is the wisest and most effective course of action.

The IRS has twice published in the Federal Register statements of its belief that the applicable tax laws pose no bar to flow-through. However, the IRS has also advised PSE&G and the Board that it expects to issue PSE&G a PLR that would create an obstacle to flow-through that the IRS itself has recognized is not present in the statute. The IRS has also taken the position that the Board would not be able to appeal an adverse PLR. Considering all of these IRS statements, the Board believes that the PLR is not the best mechanism to resolve PSE&G's legitimate question.

Rulemaking is the best mechanism for that purpose. Rulemaking is an open, transparent process, subject to public notice and comment and the obligation of the agency to respond to those comments, and subject to judicial review. In contrast, the PLR process is a closed one in which the IRS has not sought public comment, allowed the Board and the RPA to comment only through PSE&G, has not obtained comment from other regulatory agencies or consumer organizations, and has stated is not subject to judicial review.

PSE&G further asserts that the issuance of the PLR would leave the status quo undisturbed. The Board disagrees. The status quo is that the Board has not ordered PSE&G to flow through its deferred tax benefits, because the IRS has not yet resolved whether flow-through would violate applicable tax law. The issuance of an adverse PLR would change that status quo. It would be the only resolution of the flow-through question between the IRS and the Company if no final rulemaking is issued.

The IRS is currently considering two means of resolving the flow-through question: acting on the requests by utilities for PLRs, and promulgating a regulation. The IRS has advised PSE&G and Board Staff that it can resolve the question through PLRs without awaiting its pending rulemaking; indeed, the IRS has advised that it intends to do exactly that. Furthermore, the scope of the IRS action is not limited to New Jersey utilities that have transferred their generating assets, since PSE&G advised in oral argument that a PLR was issued on April 24, 2006 for Connecticut Light & Power Company. If the IRS refuses to hold the PLRs in abeyance pending the completion of the rulemaking, and indeed issues all of the PLRs that utilities have requested on this issue, it is at least a reasonable possibility that the IRS will not complete a rulemaking to address the same issue that it will have already addressed through PLRs. In that event, if the IRS is correct in its belief that a third party cannot appeal a PLR, the Board would never have the opportunity to challenge the IRS' decision.

For this reason, the issuance of the PLR would materially change the status quo, to the detriment of PSE&G's ratepayers. Conversely, the withdrawal of the PLR request will maintain the status quo, in which the Board will not have ordered PSE&G to flow through its deferred tax benefits because the IRS has not yet spoken.

The Board emphasizes that neither its direction in the April 26, 2006 Order regarding the Company's PLR request, nor the denial of the Company's request for reconsideration, should be interpreted either as ordering flow-through or as a step toward ordering flow-through. If the Board considers taking such action in the future, it would be the subject of a separate proceeding in which PSE&G would retain the right to assert all of the arguments that it has previously asserted in connection with the April 26, 2006 Order and the motion for reconsideration of that Order.

The Board will consider those arguments and any others that the Company asserts as provided for in the 1999 Order in the context of such a future proceeding, if one occurs.

At oral argument, PSE&G contended that it needed to have the PLR issued in order to have guidance on an important tax question. However, even though the Final Order expressly held open the ITC flow-through issue, PSE&G took action without any such guidance. Specifically, the Company accounted for the ITC as a reduction to the extraordinary charge it incurred for the write-down of its generation assets. PSE&G Form 10-K, p. 8, cited in PSE&G motion at 5.

PSE&G also asks the Board to consider the context in which the Company transferred its generation plants to PSEG Power, the language of the Board's August 24, 1999 Final Order addressing the treatment of tax credits at the time of that transfer, and differences between the language of that Final Order and the orders concerning transferred generation assets of other utilities. PSE&G motion, at 2. PSE&G asserts the Final Order clearly expresses the Board's intention (i) that if the IRS determined in a PLR that the ITC cannot be passed on to customers, then those tax credits would not be passed on; and (ii) that if the IRS determined that the ITC could be passed on to customers, the flow-through would not automatically occur; instead, the Board would consider what PSE&G describes as "the substantial benefits provided to ratepayers in the electric restructuring process" and determine whether flow-through was appropriate. PSE&G motion, at 2-3.

The interpretation that PSE&G offers is not relevant to whether the PLR request should be withdrawn or held in abeyance. PSE&G's interpretation speaks only to what should follow after the IRS resolved the flow-through question. Accordingly, PSE&G's interpretation offers no reason to reconsider the Board's direction in the April 26, 2006 Order.

If in a future proceeding, the Board considers whether to order flow-through, it will consider the relevant factors described in the Final Order in determining what action is appropriate, giving consideration to the issues resolved in the Stipulation of March 17, 1999, the Board's modifications to that Stipulation, and other relevant considerations which the parties might bring to the Board's attention.

Finally, the Board appreciates PSE&G's offer to

> acknowledge and agree that, in the event that the IRS' final regulations

retroactively permit flowthrough to customers, the Board could then consider any action it may take, including seeking to flow through such funds, giving due consideration to the elements of the Settlement and the Board's Final Order, subject to PSE&G's continuing right to argue its position based on the intend of the Final Order.

[PSE&G motion, at 2.]

However, the Board finds no basis in this suggestion to modify the April 26, 2006 Order. The suggestion does not take into account the scenario in which the IRS seeks to resolve the pending flow-through issues solely through PLRs, without ever subsequently taking final action on rulemaking to address the same issues for a second time. Furthermore, if the IRS promulgates a regulation that does not supersede previously issued PLRs and effectively gives those PLRs legal effect, then having the PLR issued would adversely affect the interests of the ratepayers.

For the foregoing reasons, the Board HEREBY DENIES PSE&G's motion for reconsideration of the Board's April 26, 2006 Order. Accordingly, the Board HEREBY DIRECTS PSE&G to deliver to the IRS, by 5:00 p.m. on May 8, 2006, a withdrawal of its request for a PLR. However, PSE&G may state in its withdrawal that if the IRS agrees not to issue a PLR until after there has been a final resolution of an IRS rulemaking that addresses the tax implications of flowing through the ITC to ratepayers, including any appeals from the rulemaking, then PSE&G's request for a PLR shall be deemed not to be withdrawn. PSE&G shall simultaneously file with the Board's Secretary a copy of its withdrawal of the PLR, stating the date and time on which the withdrawal was delivered to the IRS. The Board again emphasizes that its determination whether the ITC is to be flowed through to ratepayers continues to remain open pending the resolution of the issue through IRS rulemaking, and that the Board is not directing flow-through of the ITC at this time. Additionally, the Board further DIRECTS PSE&G to deliver to the IRS, by 5:00 p.m. on May 8, 2006, comments to be received from the BPU which will urge that the PLR request be held in abeyance, as well as comments by the RPA with respect to the proposed PLR.

The Board reserves the right to take such action as may be necessary to enforce this Order and authorizes the Attorney General's Office to take such action as may be so necessary.

DATED: May 5, 2006

BOARD OF PUBLIC UTILITIES
BY:

JEANNE M. FOX
PRESIDENT

FREDERICK F. BUTLER
COMMISSIONER

CONNIE O. HUGHES
COMMISSIONER

JOSEPH L. FIORDALISO
COMMISSIONER

CHRISTINE V. BATOR
COMMISSIONER

ATTEST:

KRISTI IZZO
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities